

31 August 2009

## Bollard Rightly Warns Against Over-Excitement

- Alan Bollard acknowledges turning point
- But recovery likely to be “fragile, gradual”
- Warnings about robust NZD, capped OCR
- NBNZ business survey probably a bit better
- August’s commodity prices likely still mixed

Many are becoming increasingly optimistic of a definite economic recovery. So it was interesting to hear Alan Bollard, in a 20-minute interview with Radio New Zealand this morning, being guarded about the way ahead. We have sympathy with his view.

While a turning point now seems clear enough, there is little, as yet, to guarantee it will naturally transform into the strong and sustained upswing required for us all to climb out of the big hole we’re in. Folk run the risk of getting over-excited.

Bollard’s comments – as with his newspaper piece over the weekend – seem designed to lean against such over-excitement, and, particularly, bets the RBNZ will smartly follow RBA Governor Stevens’ lead and begin to talk about the need to hike rates sooner, and by more, than previously inferred.

Of course, NZ markets are already pricing OCR hikes much sooner than the RBNZ has lately suggested. As Bollard stated this morning, the financial markets are free to think what they like - but are also prone to get it wrong on more than the odd occasion. In their eagerness to pick and ride the ups and downs, financial markets “don’t do stable very well”.

This reinforces our belief the Bank will come out with a steady as she goes Monetary Policy Statement next week, including in its projections for 90-day bank bill yields (read: the OCR), when some are hankering for a gear shift. To be sure, the local data have stabilised, even exhibited a tendency toward mild expansion, over recent months. This afternoon’s NBNZ business survey will most probably maintain this theme. And the housing market is looking perkier, when the Bank thought it wouldn’t.

Improving statistics are also undeniable on the international front, and very positively so in respect to many Asian economies. On the back of this, global growth expectations are looking much less poorly.

The RBNZ will have to feed all of this better news into next week’s MPS.

However, there will be an important offset – a major one. The Bank will have to run a substantially stronger exchange rate track through its macro forecasts. The June MPS assumption of a falling NZ dollar has been taken to the cleaners, by a market intent on punting it higher. Yes, a lot of this has reflected the recovering economic backdrop. But the extent of the NZ dollar’s rise, compared to expectations, will arguably be the biggest issue for next week’s MPS.

Bollard alluded to such this morning. It leans hard against the notion of a strong or sustained NZ recovery. And it pushes down on an inflation outlook the RBNZ already saw as moving to the low side.

As a reminder of the squeeze the currency is already imparting on the economy, this Thursday afternoon’s ANZ commodity prices will be worth noting. While international dairy prices are creeping up off extreme lows, the more general picture on commodity prices remains choppy, with the strengthening NZ dollar a strong counterweight in any case.

And it’s not as though the RBNZ can do anything to dent the climbing Kiwi. Not really. Not over the near term. Bollard said as much in this morning’s radio interview. Other central banks – such as those of Canada and Switzerland – have had a crack at bringing their currencies down, to no avail.

The RBNZ, of course, has some high hurdles before intervention can even be contemplated, let alone transacted. And it would be particularly brave of Bollard to take on the trend in FX markets at the moment, which simply invites large losses on short Kiwi positions – especially if the US dollar falls out of bed.

What Bollard can influence, of course, is the NZ cash rate. And he might yet be forced to trim it further – to the extent the much stronger than anticipated currency threatens to choke off the tentative recovery that appears to be coming through. It’s not our core view. But it’s something to bear in mind as we head into next week’s MPS, especially for those betting the RBNZ will soon become a mini RBA.

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## Domestic Interest Rates

New Zealand interest rates saw another week where the local market struggled for direction and generally followed the lead from offshore. Australian rates sold off significantly on speculation that the RBA would lift its policy rate before the end of this year and we followed, albeit with significant outperformance. For the local market, the general themes remain the same at the front of the yield curve: there is a slight chance of a cut priced into the next few months with hikes priced from early in 2010.

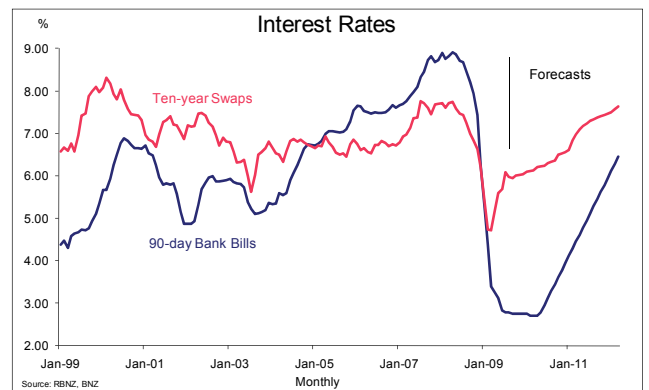
The bond market was the standout performer on the week with a record tender (\$450m) taken out with a strong bid to cover ratio. The strength was primarily in the long end and the curve flattened noticeably on the week. This was with offshore bonds generally performing poorly so was a very positive sign for NZ Government bonds. We feel the market will continue to out-perform offshore in the coming week.

	90 day bills	11/11 NZGS	12/17 NZGS	2yr swaps s/a	10yr swaps s/a	2yr/10yr swaps(bps)
21-Aug-09	2.76%	3.98%	5.74%	4.03%	5.94%	191
28-Aug-09	2.77%	4.04%	5.69%	4.15%	6.00%	185
<b>Change (bps)</b>	<b>1</b>	<b>6</b>	<b>-5</b>	<b>12</b>	<b>6</b>	<b>-6</b>

## Reuters pgs BNZL BNZM

The swaps market continued to lack inspiration in the past week and continues to wash around in familiar ranges. The 4.20-4.00% range continues to hold, finishing the week towards the top end of this range. These levels look likely to hold for now, though offshore moves, particularly the RBA board meeting on Tuesday, will probably lead the NZ market.

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## Interest Rate Technicals

### NZD 5yr Swap Rate

Outlook: Consolidation  
 ST Resistance: 5.48%  
 ST Support: 5.15%

The short-term range is in place and we look to trade a break of either. Our previous view of a break higher still seems the more likely scenario and we are very near that level now.



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### NZ 2yr-5yr Swap Spread (yield curve)

Outlook: Steepening  
 ST Support: +122

The market has taken a breather here, but has not pulled back far. We therefore expect the steepening trend to continue. Should our support at +122 be broken then this will be bought into question.



## Foreign Exchange Market

Reuters pg BNZFWDS

By recent standards, it has been a comparatively uneventful week for the NZ dollar. After hitting an 11-month high just under 0.6900, the NZD/USD spent the rest of last week trading within a relatively tight 0.6775-0.6900 range as investor sentiment continued to wax and wane.

Evidence of a global economic recovery continues to emerge, which has tended to support investors' risk appetite. Last week's US home sales and house prices data provided further evidence of an improving US housing market, while the revised estimate of June quarter US GDP fell by less than most expected. Similarly, German GDP data confirmed the economy exited recession in Q2, and the German IFO business confidence index ratified analysts' expectations for further expansion in August.

While the global backdrop certainly seems to be improving, markets now seem wary of getting overly excited about the strength and timing of the anticipated global recovery. As such, further gains in the NZD were limited last week, despite the improving global backdrop. Indeed, heavy option-related selling provided a firm 0.6900 ceiling for the NZD/USD.

After climbing to nearly 0.8250 in the middle of last week, NZD/AUD has recently slipped below 0.8150. We see further downside risks to NZD/AUD in the near-term.

Market pricing is consistent with at least one 25bps hike from the RBA by year-end following early signs of strength in Australian domestic demand and comments from RBA officials cautioning against keeping rates too low for too long. In contrast, the RBNZ has declared its intention to keep the OCR at, or below, its current level until well into 2010, and markets are currently pricing around a 50% chance of an RBNZ hike in January next year (our official view has the first OCR hike coming in July). The contrasting outlook for monetary policy has us looking for a correction back towards 0.7900-0.8000 in coming months.

We continue to expect NZD/USD to push gradually higher over coming months as the NZ economy slowly finds its feet, supported by the global economic recovery. However, for this week, strong selling interests ahead of the reported option barrier at 0.6900 look likely to be a firm cap on NZD/USD for now.

Globally, this week is full of event risk, which should help shed some light on the global outlook and risk appetite (the August NBBO and ANZ commodity prices are the only local releases). Highlights look set to be the RBA board meeting on Tuesday, US non-farm payrolls on Friday night and the G20 Finance Ministers meeting over the weekend.

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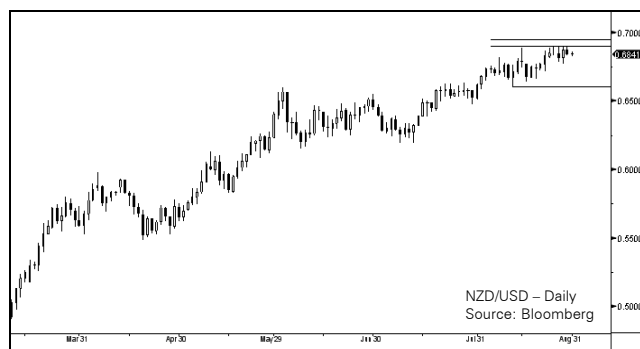
## Foreign Exchange Technicals

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### NZD/USD

Outlook: Consolidation  
 ST Resistance: 0.6900 (ahead of 0.6945)  
 ST Support: 0.6645 (ahead of 0.6590)

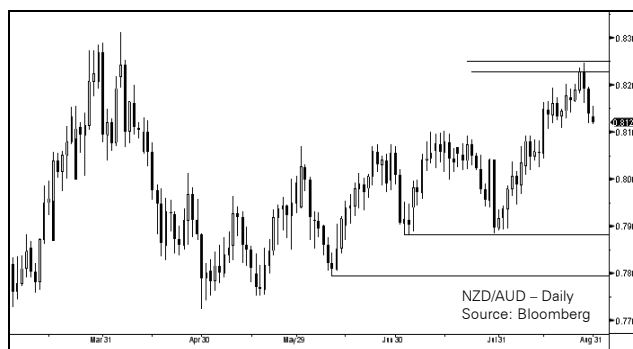
The uptrend is starting to run out of steam and the repeated failure to break above 0.6900 suggests a correction is on the cards. However, a break below the 12 August low of 0.6590 is needed to suggest the downtrend is gaining traction.



### NZD/AUD

Outlook: Sell a rally  
 ST Resistance: 0.8195 (ahead of 0.8250)  
 ST Support: 0.7890 (ahead of 0.7790)

Momentum indicators remain bullish, but the failure to break above 0.8250 suggests a correction towards at least 0.7900 is on the cards.



## Key Upcoming Events

	Forecast	Median	Last		Forecast	Median	Last
<b>Monday 31 August</b>				<b>Tuesday 1 September</b>			
NZ, NBNZ Business Survey, August			+18.7	US, Pending Home Sales, July	+1.6%		+3.6%
Aus, Private Sector Credit, July	+0.1%	+0.2%	+0.1%	China, PMI (NBS), August			53.3
Aus, Company Profits, Q2	-5.0%	-4.5%	-7.2%	<b>Wednesday 2 September</b>			
Aus, TD Inflation Gauge, August y/y			+1.9%	Aus, GDP, Q2	+0.5%	+0.6%	+0.4%
Jpn, Industrial Production, July 1st est		+1.4%	+2.3%	Euro, PPI, July y/y		-8.4%	-6.6%
Jpn, Retail Trade, July y/y		-3.5%	-2.9%	Euro, GDP, Q2 2nd est		-0.1%	-0.1%P
Euro, CPI, August y/y 1st est		-0.3%	-0.7%	US, ADP Employment, August		-250k	-371k
US, Chicago PMI, August		48.0	43.4	US, Factory Orders, July	+2.2%		+0.4%
Germ, Retail Sales - vol, July		+0.7%	-1.3%	<b>Thursday 3 September</b>			
<b>Tuesday 1 September</b>				NZ, ANZ Comdty Prices (\$NZ), August			+0.1%
Aus, RBA Policy Announcement	3.00%	3.00%	3.00%	Aus, International Trade, July	-\$850m	-\$880m	-\$441m
Aus, Current Account, Q2	-\$9.50b	-\$10.70b	-\$4.61b	UK, CIPS Services, August		54.0	53.2
Aus, Building Approvals, July	+4.0%	+3.0%	+9.3%	Euro, ECB Policy Announcement	1.00%	1.00%	1.00%
UK, CIPS Manuf Survey, August		51.5	50.8	Euro, Retail Sales, June		+0.1%	-0.2%
Euro, Unemployment Rate, July		9.5%	9.4%	US, ISM Non-Manuf, August		48.0	46.4
US, FOMC Minutes, 11 Aug Meeting				US, Jobless Claims, week ended 29/08		560k	570k
US, ISM Manufacturing, August		50.5	48.9	<b>Friday 4 September</b>			
US, Construction Spending, July		-0.1%	+0.3%	Jpn, Capital Spending, Q2 y/y		-23.0%	-25.3%
				US, Non-Farm Payrolls, August		-230k	-247k

## Historical Data

	Today	Week Ago	Month Ago	Year Ago		Today	Week Ago	Month Ago	Year Ago
<b>CASH &amp; BANK BILLS</b>					<b>FOREIGN EXCHANGE</b>				
Call	2.50	2.50	2.50	8.00	NZD/USD	0.6842	0.6849	0.6599	0.6994
1 mth	2.77	2.78	2.78	8.27	NZD/AUD	0.8126	0.8169	0.7899	0.8163
2 mth	2.78	2.80	2.79	8.21	NZD/JPY	63.88	64.63	62.51	75.77
3 mth	2.79	2.77	2.77	8.09	NZD/EUR	0.4781	0.4774	0.4625	0.4756
6 mth	2.85	2.85	2.82	8.01	NZD/GBP	0.4206	0.4150	0.3946	0.3859
<b>GOVERNMENT STOCK</b>					NZD/CAD	0.7467	0.7392	0.7103	0.7425
11/11	4.05	4.04	3.81	6.06	TWI	63.45	63.59	61.34	65.39
04/13	4.92	4.94	4.75	6.03	<b>NZD Outlook</b>				
04/15	5.34	5.40	5.26	6.00	New Zealand Dollar				
12/17	5.70	5.80	5.73	5.99					
05/21	6.11	6.23	6.53	-	Source: BNZ, RBNZ				
<b>CORPORATE BONDS</b>									
BNZ 09/10	3.90	3.84	3.92	-					
BNZ 05/15	6.68	6.71	6.84	-					
GEN 03/14	6.82	6.69	7.02	-					
GEN 03/16	7.31	7.18	7.51	-					
TRP 12/10	4.67	4.56	4.48	7.50					
TRP 06/20	7.78	7.67	7.63	7.47					
<b>SWAP RATES</b>									
2 years	4.17	4.08	3.86	7.34					
3 years	4.83	4.77	4.58	7.18					
5 years	5.43	5.40	5.25	7.08					
10 years	6.01	5.99	5.92	6.98					

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